

# **MEMORANDUM**

on

## **Incorporating a charity**

### **Why? and How?**

January 2024

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## Incorporating a charity: Why? and How?

### 1. Types of charity structure

- 1.1 Charities are constituted in many different forms. The most common being:-
- a charitable trust;
  - a charitable unincorporated association;
  - a charitable company limited by guarantee; and
  - a charitable incorporated organisation (CIO).
- 1.2 The first two types of charity listed above are “unincorporated charities”. The third and fourth are “incorporated charities.”
- 1.3 It should be noted that charity trustees are not always referred to as such in a charity’s governing document. For example, with a charitable unincorporated association, the committee members for the time being are, at law, charity trustees; and with a charitable company limited by guarantee the directors for the time being are the charity trustees. For ease, however, we have simply referred to “trustees” throughout this document.

### 2. Operating as an unincorporated charity: what does this mean?

- 2.1 As an unincorporated charity, it is the trustees of the charity who, in their personal names, hold property (for example, land and investments) and enter into contracts with third parties – such as landlords, employees and funding bodies.
- 2.2 The disadvantages of the above are:-
- upon the retirement or appointment of trustees it will be necessary to transfer title to charity property and novate or assign contracts; and
  - it is the trustees in their personal capacity who (a) will need to sue and who will be sued in relation to any litigious matters involving their charity and (b) will be responsible for the debts of their charity.

2.3 For completeness, we have set out below some mechanisms that are available to help alleviate the issues arising from charity property having to be held in trustees' personal names; it should be noted, however, that none of these give the trustees limited liability:-

- land can be held in the name of the Official Custodian for Charities;
- land and other charity property can be held in the name of custodian trustees;
- investments can be held in the name of a nominee; and
- the trustees can apply to the Charity Commission for a certificate of incorporation. This would allow them to hold charity property and enter into contracts in the name of the charity rather than in their individual names but this not the same as incorporation of the charity itself.

2.4 It should also be noted that charity trustees who have incurred personal liability resulting from the debts of their charity or any litigious matters involving their charity, are entitled to be indemnified from the assets of the charity if they have acted honestly and reasonably. However, this right of indemnity will be of little value where any such liability incurred exceeds the assets of the charity.

2.5 Charity trustees can purchase trustee indemnity insurance which is designed to cover any above mentioned shortfall. In reality, however, trustee indemnity insurance is often little more than a "comfort blanket" for trustees because (a) there are legal limitations on what this type of insurance can cover and (b) charities have found it difficult to prove to insurance companies that they have a legitimate claim. Therefore, the incorporation route is the best way for charity trustees to protect themselves.

### **3. Operating with a corporate legal structure: what does this mean?**

3.1 If a charity has a corporate legal structure, it has its own legal personality which means that it can hold assets (such as land and investments) and enter into contracts in its corporate name.

3.2 The advantages of the above are that:-

- there will be no need to transfer title to charity property or novate or assign contracts each time a trustee retires or is appointed;
- it is the charity, rather than the individual trustees, who can sue and be sued; and
- the trustees will have limited liability in that they will not, subject to certain exceptions, be personally liable for the debts of the charity, even if there are insufficient funds to honour such debts. (The exceptions to limited liability include, for example losses incurred by a charity as a result of a breach of trust/duty; non payment of PAYE and National Insurance contributions; wrongful trading situations; and payments made to a trustee when he/she is not legally qualified to act as a trustee).

3.3 Consequently, if a charity is a “service providing” charity (rather than, say, a grant making charity) which owns or occupies land, has employees and enters into other types of contracts with third parties, its trustees should consider the merits of incorporating.

#### 4. Which type of corporate structure?

4.1 The two main types of corporate structure available for charities are:-

- the CIO; and
- the charitable company limited by guarantee.

4.2 The CIO is a relatively new corporate legal structure (available since 2013) which has been created specifically for charities. Before the introduction of the CIO, generally, in order for a charity to operate under a corporate structure, it had to be established as a company limited by guarantee. The company limited by guarantee was not designed for charities. Hence a charity established as a company has the added burdens of, amongst other things (a) having to comply with both charity law and company law and (b) being regulated by both the Charity Commission and Companies House.

- 4.3 There are some similarities between the CIO and a charitable company limited by guarantee in that:-
- CIOs have members as well as trustees (see the section below regarding the different types of CIO);
  - from January 2018 all CIOs will be included in the Register of Business Names Index maintained by Companies House, which means that the names of CIOs will (a) show up when searching the Companies House website and (b) be subject to the regulations regarding “sensitive words or expressions” – however, Companies House and the Charity Commission have agreed a pragmatic approach with regard to CIOs that wish to use the words “charity”, “charitable”, “association”, “foundation” or “trust” in their names in that they will not be required to contact Companies House before submitting their application for registration to the Charity Commission;
  - CIOs are subject to the same insolvency and dissolution procedures as companies (although there is an additional bespoke voluntary dissolution procedure for CIOs);
  - the company director disqualification rules apply to CIOs; and
  - the rules governing CIO administration are similar to those of a company, in that CIOs are also required to maintain up to date registers of trustees and members.
- 4.4 In short, however, as the CIO provides the benefit of operating as a separate legal entity and affords the trustees limited liability without the burdens of having to register with, and be regulated by, Companies House, subject to certain exceptions (see paragraph 4.5 below regarding charges over charity assets), we would recommend trustees opt for the CIO model.
- 4.5 Companies House maintains a register of charges over company assets but there is no searchable register of charges over CIO assets. As a consequence, the CIO model may not be appropriate for larger charities wishing to enter into secured borrowing arrangements.

## 5. Foundation CIO or Association CIO?

### 5.1 There are two types of CIO:-

- *Foundation CIO*

This type of CIO would be appropriate where it is not intended that there will be a wider membership in that the trustees and the members will be one and the same – for example, in relation to the incorporation of a charitable trust.

- *Association CIO*

This type of CIO would be appropriate where it is intended that there will be a wider membership (ie. where membership is open to the general public or a specified section of the public) – for example, in relation to the incorporation of an unincorporated association.

### 5.2 The Charity Commission has produced model constitutions for both types of CIO and it expects these to be adopted without significant departure from the provisions of these documents. Some umbrella bodies, such as the Pre-School Learning Alliance, have agreed with the Charity Commission a bespoke CIO constitution (based on the Commission's standard model) for their member charities.

## 6. The incorporation process at a glance

### 6.1 It is not possible to “convert” an unincorporated charity into a corporate structure. Therefore it will be necessary to establish a new corporate charity and register it with the Charity Commission. (For simplicity, we are assuming that the corporate structure will take the form of a CIO rather than a company limited by guarantee). Once registered with the Charity Commission it will be necessary to transfer the assets, liabilities and activities of the existing unincorporated charity to the CIO. In most cases, this can be done by way of a simple transfer agreement. Subject to certain exceptions, the unincorporated charity will then be wound up and removed from the register of charities. Please see the appendix to this paper for a summary of the various stages of a typical incorporation.

## **7. Some matters that trustees need to consider before incorporating**

### Get your house in order

- 7.1 The Charity Commission has confirmed that it will not register the new corporate charity unless the unincorporated charity has (a) filed its most recent annual return and accounts with the Charity Commission, as applicable and (b) any outstanding governance issues have been resolved.

### Power to incorporate

- 7.2 It will be necessary to check the governing document of the unincorporated charity to ensure that it has the power to incorporate. There is often no specific power to incorporate. Therefore a power to merge with another charity which has the same or similar objects or a general “catch-all” power will usually suffice.
- 7.3 If there is no relevant power, it will be necessary to amend the governing document accordingly. This may require the prior consent of the Charity Commission.

### Objects

- 7.4 There are very limited circumstances in which a charity can change its objects. This means that, in general, the assets of the unincorporated charity will need to be applied for the same purposes once they are transferred to the CIO. Consequently, in general, the objects of the CIO will need to be drafted so that they are the same or substantially similar to those of the unincorporated charity.

### Third party funding contracts/arrangements

- 7.5 Trustees will need to satisfy themselves that the unincorporated charity’s funding will not be adversely affected or stopped as a result of the incorporation of the charity. Therefore, third party funding contracts/arrangements should be reviewed and, where necessary, the prior consent of the third party funder will need to be obtained. In any event, even where strictly speaking no prior consent is required, we recommend that the funders are put on notice of the proposed incorporation.



### Leases/licences

7.6 Where the unincorporated charity rents or licences premises, the terms of the lease/licence agreement will need to be reviewed and the prior consent of the landlord/licensor obtained as necessary/appropriate. Again, in any event, even where strictly speaking no prior consent is required, we recommend that the landlord/licensor is put on notice of the proposed incorporation.

### Consent from other regulators

7.7 Depending on what the unincorporated charity does, it may be necessary to obtain consent from other regulators such as Ofsted, the Care Quality Commission or the Regulator of Social Housing.

### Consent from umbrella bodies

7.8 If the unincorporated charity is a member of an umbrella body, it will be necessary to ascertain whether there are any restrictions or limitations relating incorporation in the body's rules or whether the body's prior consent will be required. In most cases it will be simplest to contact the umbrella body direct in order to clarify the position.

### Disclosure and Barring Service (DBS) certificates

7.9 It may be necessary to obtain new DBS certificates for the trustees (and relevant staff) in relation to the CIO.

### Pensions

7.10 If the unincorporated charity has a pension scheme deficit this debt may crystallise upon incorporation. It is essential, therefore, that expert pensions advice is obtained in such circumstances.

7.11 In any event pension fund trustees should be contacted prior to the incorporation and, where necessary, their consent to the incorporation obtained.

### Permanent endowment

7.12 If the unincorporated charity holds assets as permanent endowment (ie. where assets have been given to the charity on the basis that the capital is to

be held and maintained in perpetuity and only the income generated can be used by the charity), then specific procedures will need to be followed in order to allow the CIO to hold the permanent endowment.

#### Legacies

7.13 If the unincorporated charity is in receipt of legacy income it may be necessary to keep it in existence following incorporation for the purposes of passing legacies to the new CIO.

#### Restricted funds

7.14 Any restricted funds of the unincorporated charity must continue to be held as such when transferred to the new CIO.

#### Employees

7.15 Employee contracts will be transferred from the unincorporated charity to the CIO pursuant to the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE). "TUPE notices" will therefore need to be served on all employees.

#### Completion date of incorporation

7.16 It is preferable, though not generally essential, for the completion date of the incorporation (ie. the date upon which the assets, liabilities and activities of the unincorporated charity transfer to the CIO) coincides with the accounting year end of the unincorporated charity.

## **8. Conclusion**

The incorporation process may, on the face of it, seem complicated and daunting. However, trustees rarely regret the time and expense incurred in affording themselves and their charity the benefits of operating with a corporate structure. Furthermore, because of the protection of limited liability it is often easier to retain and recruit trustees.

We would be able to provide advice and assistance with the incorporation of your charity and if you would like more details please do contact Sarah Chiappini: details below.

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*This note provides a general summary only and it does not constitute legal advice. It is recommended that specific advice is sought in relation to the particular facts of a given situation.*

## APPENDIX

## Summary of the various stages of a typical incorporation

The incorporation process would generally involve:-

1. the trustees of the unincorporated charity resolving to incorporate (after having satisfied themselves that (a) their house is in order and (b) the charity has the necessary power to incorporate and that incorporation would be in the best interests of the charity);
2. if the unincorporated charity is an unincorporated association, holding an AGM/EGM whereby the members give “in principle” approval to the proposed incorporation;
3. notifying and obtaining the consent, as necessary, of third parties (eg landlords and funders);
4. notifying and obtaining the consent, as necessary, of other regulators and any umbrella bodies;
5. assessing whether or not new DBS certificates need to be obtained and making applications as necessary/appropriate;
6. assessing the position regarding pensions, permanent endowment, legacies and restricted funds;
7. submitting the CIO constitution; the Charity Commission application for registration, together with supporting documents; and the Charity Commission *Trustee eligibility declaration* to the Charity Commission;
8. once the CIO is registered with the Charity Commission:-
  - applying to HMRC for a charity tax reference number for the CIO; and
  - applying for the CIO to be registered with any other regulators or umbrella bodies as appropriate;

9. dealing with the “TUPE notices” regarding the transfer of employment contracts to the CIO;
10. holding respective meetings of the trustees of the unincorporated charity and the CIO, whereby they resolve to proceed with the incorporation and execute the transfer agreement;
11. giving effect to the transfer agreement by:-
  - freehold land: executing legal transfer;
  - leases/licences: executing consent to assignment, as necessary/appropriate;
  - plant and equipment: no action required, pass by delivery;
  - bank account(s): banks will usually require a new account(s) to be opened for the CIO and if this is the case, it will be necessary to transfer funds from the existing account(s) to the new account(s);
  - staff: no action required as their employment contracts will automatically transfer pursuant to TUPE (see paragraph 9 above);
  - third party contracts: subject to any required third party consent, transferring contracts into the name of the CIO;
  - other third parties: giving notice of transfer as necessary/appropriate;

12. HMRC:-
  - ensuring that HMRC has issued a charity tax reference number for the CIO pursuant to the application referred to at paragraph 8 above and informing HMRC that the charity tax reference number for the unincorporated association is no longer required;
  - registering the CIO as an employer for PAYE, as applicable;
  - obtaining a VAT certificate for the CIO, as necessary/appropriate;
13. arranging for the CIO to be registered with the Information Commissioner's Office as necessary/appropriate;
14. arranging for membership declarations to be signed by all prospective members of the CIO where there is to be a wider membership (ie in respect of Association model CIOs);
15. completing the statutory registers of trustees and members;
16. arranging for the Charity Commission registration number of the CIO to be shown on all stationery (including invoices and cheques) and on the website and email footers;
17. updating other aspects of the charity's website as appropriate;
18. subject to clarifying the position regarding permanent endowment and legacies, arranging for the Charity Commission to remove the unincorporated charity from the Register of Charities/register the incorporation with the Charity Commission.